DOCUMENT RESUME

ED 297 190 CE 050 720

AUTHOR Rinehart, Eric L., Ed.
TITLE Guidelines for Determining the Feasibility of a Small Business Incubator.
INSTITUTION Illinois State Dept. of Commerce and Community Affairs, Springfield.
PUB DATE Nov 85
NOTE 24p.; For related documents, see CE 050 718-719.
PUB TYPE Guides - Non-Classroom Use (055)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Adults; *Business Administration; Cooperative Programs; *Entrepreneurship; *Facilities; *Feasibility Studies; Financial Support; Needs Assessment; Program Administration; Program Development; *Small Businesses
IDENTIFIERS *Illinois; *Small Business Incubators

ABSTRACT

An increasingly popular economic development tool to improve the success rate of new firms is the small business incubator. These are buildings in which a number of new or growing businesses can locate and operate at a much lower overhead cost than in conventional space where market rates prevail. Incubator facilities are characterized by access to shared, centralized services such as clerical and administrative help, receiving and shipping facilities, conference rooms, computers and word processors, and business assistance resources. Incubator facilities are generally targeted toward small firms that may lack the management, technical, and financial ability to survive on their own. As an aid to potential incubator sponsors and developers, this booklet offers guidance in determining the feasibility of a small business incubator. Information is included on doing an incubator market analysis (accessing the level of entrepreneurial activity, analyzing characteristics of the economic base and of large business purchases, determining supply and demand for commercial space, and assessing the small business support network). Guidelines for incubator implementation include information on establishing a formal working group and an appropriate focus, locating and selecting a building, and developing a financial plan. Worksheets are provided for use in analysis. (KC)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED297190

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

This document has been reproduced as received from the person or organization originating it.

Minor changes have been made to improve reproduction quality.

Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL HAS BEEN GRANTED BY

E L Rowland

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

Guidelines for Determining the Feasibility of a SMALL BUSINESS INCUBATOR

CE 058 720

Illinois Department of Commerce and Community Affairs
November, 1985

GUIDELINES FOR DETERMINING THE FEASIBILITY OF A SMALL BUSINESS INCUBATOR

Illinois Department of Commerce and Community Affairs
November, 1985

TABLE OF CONTENTS

PAGE

INTRODUCTION i

I. INCUBATOR MARKET ANALYSIS 1

A. Assess Level of Entrepreneurial Activity 1
B. Analyze Characteristics of the Economic Base 1
C. Analyze Characteristics of Large Business Purchases 1
D. Determine Supply and Demand for Commercial Space 1
E. Assess the Small Business Support Network 2

II. INCUBATOR IMPLEMENTATION

A. Establish a Formal Working Group 3
B. Establish an Appropriate Focus for the Incubator 3
C. Locate and Select a Building 4
D. Develop a Financial Plan 4

WORKSHEETS

I.A. Level of Entrepreneurial Activity 5
I.B. Characteristics of the Economic Base 7
I.C. Characteristics of Large Business Purchases 8
I.D. Real Estate Supply 9
Real Estate Demand 10
I.E. Small Business Support Network 11

II.A. Incubator Working Group 13
II.B. Focus of Business Incubator 14
II.C. Facility Site Selection Evaluation 16
II.D. Financial Plan - Incubator Cost Detail 17
Financial Plan - Incubator Profits and Loss 18

INTRODUCTION

Environmental factors, such as rapid technological change, expansion and globalization of markets, and increasing job specialization, make it increasingly difficult for many small businesses to compete. New small businesses are often so vulnerable that a single serious mistake in location, purchasing, marketing or personnel may spell disaster. An estimated 2,000 firms close their doors each year because of one serious mistake. Nine out of ten small businesses fail due to management problems which often could have been foreseen.

An increasingly popular economic development tool which helps improve the success rate of new firms is the small business incubator. These are buildings in which a number of new or expanding businesses can locate and operate at a lower overhead cost than they could in conventional market rate space. Small business incubators usually provide tenants with access to shared, centralized services such as clerical and administrative help, conference rooms, photocopy, receiving and shipping facilities, word processors, and business assistance.

Incubator facilities are targeted toward small firms that may lack the management, technical, and financial ability to survive on their own: firms that can gain tangible benefits from the common support services. Small businesses in incubators can keep overhead costs manageable by paying for services on a shared, fee-for-service basis. Cash flow benefits, access to assistance sources and interaction with other entrepreneurs in an incubator have proven to greatly improve the chance of success for start-up companies.

Incubator facilities have been started and operated by cities, counties, regional authorities, large corporations, small companies, universities, chambers of commerce, not-for-profit development groups, and private real estate developers. But whatever entity decides to establish a small business incubator, it should carefully examine its feasibility before expending much time or money in creating such a facility. One of the important elements in a feasibility study is a market analysis that helps to provide an indication of an incubator's potential economic success. Another key aspect of a feasibility study is to determine if adequate funding exists to acquire, rehabilitate, and equip an incubator facility, as well as whether the projected cash flow will cover the projected expenses. In addition to these two key analyses, it is also important to determine if there will be an adequate small business support network within the community in which the incubator will be located. Should all of these factors prove favorable, a well thought out implementation program can be established.

As an aid to potential incubator sponsors and developers, this booklet offers guidance in determining the feasibility of a small business incubator. For further information concerning the materials included herein, contact the Illinois Department of Commerce and Community Affairs.

I. INCUBATOR MARKET ANALYSIS

To determine if a community has a market for incubator space, five major aspects of the local economy should be analyzed:

A. Level of entrepreneurial activity in the community,

B. Characteristics of the economic base of the area,

C. Characteristics of large business purchasers,

D. Supply and demand for incubator-type space, and,

E. Assessment of the small business support network in place.

Several model forms are included with this document to aid in the incubator market analysis.

A. Assess Level of Entrepreneurial Activity

It is important to assess the level of local entrepreneurial activity in a community. The rate of new business start-ups, number of business permits issued, patents issued, number of home-based businesses, etc., are indicators of potential demand for incubator type space and support. These indicators also help to identify the growing sectors of the economy -- information which a sponsoring organization might use to help decide what type of incubator businesses should be recruited and what type of incubator space should be created.

B. Analyze Characteristics of the Economic Base

Potential incubator sponsors should view the industrial makeup of the local economy to determine if a potential for new business activity exists. For example, if a community has a stronger machine tool industry than other areas, it might decide to target its incubator efforts to supporting this industry. If, on the other hand, a community has a lower concentration of advanced technology firms than other areas, it might target its incubator efforts to this industry in order to diversify the local economy.

C. Analyze Characteristics of Large Business Purchases

Potential sponsors should analyze the characteristics of large companies in the area to determine potential markets for new small businesses. For example, large companies often purchase a significant amount of supplies, raw materials, and support services from outside the local economy. These purchases might become a stable source for new business creation. In addition to providing a potential market for local small business products, major businesses are often the community's primary source of spin-off firms. The type of local industry, the probability of supplying local large firms, and the level of spin-off activity should be considered when deciding on the type of incubator to establish.

D. Determine Supply and Demand for Commercial Space

The fourth aspect of the local economy to be examined is the real estate market. For an incubator to succeed, it must fill a real market need. Therefore, the supply and demand for below-market space must be carefully assessed. To determine the supply, an inventory of available commercial, wholesale, and other space should be taken.

The inventory of available, rentable space should list types of commercial property (i.e., retail, manufacturing, office space) as well as the prevailing market rates. If the inventory shows the community has a glut of cheap manufacturing space, then, obviously, the incubator sponsor needs to look very critically at any proposal to establish an incubator for manufacturing firms.

An additional element included in the analysis is the type of lease arrangements available. Often start-up businesses cannot commit themselves to long-term leases.

The demand side of the equation is equally as important. A review of approximately fifteen incubator feasibility studies suggests that surveys and interviews of realtors, existing new small businesses, banks, local development companies, etc., can give a general indication of the level of demand in the community for incubator-type space. It is important to break demand down into specific types of demand for rentable facilities.

E. Assess the Small Business Support Network

Finally, it is important to examine the degree to which a community has formalized its support for small business. If a survey of the community reveals there are few formal business development programs/services offered, this fact should be considered when deciding whether to establish an incubator.

Incubators complement and draw upon other local small business support programs. A support network is particularly important to the potential success of incubator tenants. An incubator itself will have limited local resources at its disposal, and operational costs will be affected if a community lacks a strong small business support network. Sponsors should help develop or strengthen a local network before they begin incubator development.

Potential support network members should be contacted early in the process. The first contact(s) should be with individuals who are likely to participate in supporting the incubator and its tenants and who would be influential in encouraging others to get involved.

A list of individuals or organizations expressing an interest in the project should be compiled so the interested parties can be recontacted later. Some members of this group may be in a position to commit financial resources to the project.

If surveys and interviews show that a strong small business support network does exist, the information can be used to identify potential resources and support services for incubator tenants, and to identify other local groups with similar objectives that may be valuable additions to the incubator development working group.

II. INCUBATOR IMPLEMENTATION

When the community has completed its incubator market analysis, the sponsoring organization will have needed information on the: level of potential interest in and support for an incubator facility; supply and demand for commercial real estate by business type; current and potential level of entrepreneurship in the community; and the strength of the small business support network in the community.

The next steps are designed to establish major working and operational plans for the small business incubator. These steps include:

A. Establish a formal working group,

B. Establish an appropriate focus for the incubator,

C. Locate and select a building for the incubator, and

D. Develop a viable financial plan for the incubator

Several model forms are included with this document so as to aid in the preparation of operational plans.

A. Establish a Formal Working Group

The local working group is responsible for formulating a sound plan and sticking with it through its implementation. The working group should consist of key members of the community -- bankers, business leaders, elected officials, educators, labor, and other interest groups. The members should be decisionmakers in their respective organizations who can commit resources. In addition, the group should be representative of a broad range of community organizations and skills.

The primary responsibilities of the working group include: completing the necessary market research, gaining support for the incubator from other community organizations, and providing guidance and/or direct involvement in critical phases of the project's implementation.

B. Establish an Appropriate Focus for the Incubator

The incubator sponsor must insure that the incubator is developed within the local economic and support framework. Specific objectives should be determined and should set the focus, type, and structure of the business incubator.

For example, incubators can focus on promoting employment growth by creating a specific number of jobs; promoting economic growth by creating new businesses; diversifying the local economy by developing an advanced technology sector; or revitalizing a business area by rehabilitating commercial real estate.

C. Locate and Select a Building

In cooperation with local developers and real estate agents, the sponsor should select the potential building(s) suitable for use as an incubator. For each potential site, the incubator sponsor should consider the following factors:

- suitability of building (does the potential building suit the needs of the potential tenants?)
- location (is it accessible to suppliers, customers, and employees; are public transportation and parking available?)
- availability of building (can it be purchased or leased?)
- price of building, estimate of rehabilitation needs and costs, and estimate of operating costs (is the cost reasonable?)

D. Develop a Financial Plan

To determine the financial feasibility of a small business incubator project, the following factors should be considered:

- Identify total project cost including land, building construction, and renovation costs and working capital needs. Costs should be based on vendor's or contractor's estimates so that costs can be determined as precisely as possible.
- Identify the source of funds, the term/rate, amount, annual debt service, and lien position. Consider sources including banks, federal grants, public and private resources, and state and federal loans or grants.
- Prepare a monthly and yearly cash flow statement. Several key assumptions must be made including the rental charge per square foot; the average vacancy rate of the facility; the anticipated utilities, maintenance, service, and other charges; and the incubator's management expenses. Several different assumptions should be used, and cash flows for each set of assumptions should be developed.

The financial plan statement should be carried out three to five years to determine when the incubator will reach a breakeven point. These steps are all important in showing potential investors the viability of the project and will identify the financial needs to assure the project's success.

SECTION I. A.

LEVEL OF ENTREPRENEURIAL ACTIVITY

The following worksheet can be used in gathering data on the level of entrepreneurial activity in a community. Results should be viewed as an indicator of potential demand for below-market space and new business support services.

DATA:	SOURCES:
Number and types of new corporations formed during last 3-5 years	Secretary of State's Office - Corporation Unit
Number and types of new start-ups (other than corporations)	City License Bureau and County Clerk's records
Number and type of business permits issued	City and County records
Number and type of patents issued	U.S. Patent Office records (Can be accessed at the Illinois State Library and the Chicago Public Library.
Level of participation in organizations	Survey of Trade Associations, Chambers of Commerce, Entrepreneurial Clubs

SECTION I. A.

DATA:	SOURCES:
Level of attendance at pre-business workshops and business education courses	SBA, SCORE, SBDC's, Business Schools, Chambers of Commerce
Number of locally generated spin-off companies formed in last three years (number, type, parent firm)	Survey of major local corporations, chamber of commerce members, banks, venture capitalists.
Extent of new business failures (number and type)	City, County and/or State records, Dun and Bradstreet
Number of start-up business plans being considered by local individuals	Interviews and surveys of local banks, SBA "503" companies, accounting firms, attorneys, and local venture capitalists.

SECTION I. B.

CHARACTERISTICS OF THE ECONOMIC BASE

List major types of business activity in the community. Note companies in each industry type, by SIC code, gross sales, number of employees. Compare the local economic activity, by major industry classification, with the number and size of businesses in other similar size communities. The comparison should help to identify community economic strengths, the surplus or deficit of different types of businesses, and major industrial concentrations.

Local Companies Name/Gross Sales/# Employ.	Comparison City # Firms/# Per Capita	Local Firms # Firms/# Per Capita
Non Durable Goods Mfg.		
Durable Goods Mfg.		
Transportation and Utilities		
Wholesale Trade		
Retail Trade		
Commercial Services		
Personal Services		

SECTION I. C.

CHARACTERISTICS OF LARGE BUSINESS PURCHASES

For the major companies in your community, identify the total dollar volume of purchases from "outside" suppliers by type of product/service purchased (e.g., raw material, professional services, other support, manufactured goods, and office supplies). For each major company listed in your tabulation, identify those with formal small business subcontracting programs and those with a high number of local contractors. Such information may identify opportunities for new small business start-ups.

Major Company Name	Type of Product/ Service Purchased	Outside Supplier Name/Location/Dollar Value
Raw Materials		
Manufactured Goods		
Professional Services		
Other Support Services		
Office Supplies		

SECTION I. D.

REAL ESTATE SUPPLY

Identify the number of sq. ft. of available space by rent level, the length of the average commercial lease by type of commercial property, and the quality of property.

Type Space	No.Sq.Ft.	Rent Low/Market Rate/High	Lease # Yrs	Quality Location/Use
Retail				
Office				
Light Mfg.				
Industrial				
Warehouse				
R&D facility				

SECTION I. D.

REAL ESTATE DEMAND

Survey local real estate brokers, property management firms, construction firms, etc. Ask respondents to rate on a continuum from low to high the anticipated level of demand in the community for various types of facility space and the expected vacancy and turnover in space.

	Anticipated Demand Low/Medium/High	Rates Vacancies/Turnover
RETAIL SPACE		
Commercial Realtors		
Commercial Bankers		
Construction Firms		
Local Econ. Dev. Org.		
OFFICE SPACE		
Commercial Realtors		
Commercial Bankers		
Construction Firms		
Local Econ. Dev. Org.		
LIGHT MANUFACTURING		
Commercial Realtors		
Commercial Bankers		
City/County Officials		
Construction Firms		
Local Econ. Dev. Org.		
INDUSTRIAL SITES		
Commercial Realtors		
Commercial Bankers		
Construction Firms		
Local Econ. Dev. Org.		
HI TECH R&D FACILITIES		
Commercial Realtors		
Commercial Bankers		
Construction Firms		
Local Econ. Dev. Org.		

SECTION I. E.

SMALL BUSINESS SUPPORT NETWORK

Examine the ability of the community to provide the necessary support for the incubator, including, but not limited to, technical assistance and training, assistance in attracting employees, assistance in attracting prospective tenants, and assistance in business start-up financing.

DATA:	SOURCES:
Availability of community pre-business and continuing business workshops.	List Sources, e.g., Colleges, SCORE, Chamber, etc.
Technical and management assistance programs, e.g., product search and evaluation, overall management, marketing, accounting.	List sources, e.g., Universities, Community Colleges, Existing Businesses
A local capital fund to assist businesses.	List source, amount of funds--banks, venture capital, city programs
Available state or federal government small business loan programs.	List source, amount of funds, and key contact
General local lending policies conducive to small business lending.	List lending requirements

SECTION I. E.

A service providing new businesses with information on available technical and financial sources?	List, e.g., Small Business Development Centers, Universities, Community Colleges, Chambers, etc.
Local policies to encourage small business formation.	Tax Abatements, Enterprise Zone Status Incentives, and Other Special Benefits.
A one-stop business permit center or fast track permit process.	List major permits required, contact person, and other details.
Adequate media coverage of issues of concern to small businesses?	Media coverage, Chamber membership reflects commitment, etc.

SECTION II. A.

INCUBATOR WORKING GROUP

This worksheet can be used to determine the range of community organizations and skills you would like to include in your incubator group. The emphasis should be on getting as broad a range as possible. This should include the private sector (both small businesses and representation from large corporations) and the public sector.

1) Local Government — NAME:
- ____ Mayor
- ____ City Council Member
- ____ City Manager
- ____ Economic Development Director
- ____ Other _____

2) Private Industry
- ____ Company Officer
- ____ Purchasing Officer
- ____ Real Estate Developer
- ____ Architect
- ____ Law Firm
- ____ Management or Accounting Firm
- ____ Engineering Firm
- ____ Construction Company
- ____ Other _____

3) Private Lending Organization
- ____ Commercial Bank
- ____ Savings and Loan
- ____ Venture Capital Group
- ____ Other _____

4) Local Development Organization
- ____ Chamber of Commerce
- ____ Local Development Corporation
- ____ Industrial Development Council
- ____ Private Industry Council
- ____ Other _____

5) Community Organization
- ____ Kiwanis Club
- ____ Jaycees
- ____ Other _____

6) Educational Institution

a) University
- ____ President
- ____ Professor of Business or Planning
- ____ Director, Small Business Development Center
- ____ Other _____

b) Community College
- ____ President
- ____ Professor of Business or Planning
- ____ Director, Small Business Development Center
- ____ Other _____

SECTION II. B.

FOCUS OF BUSINESS INCUBATOR

The information requested on this worksheet will help you determine the needs of the community and the form a successful incubator should take. By identifying the needs in each of the following categories, using the information collected, the community can better select the focus of its facility.

1) Organization of Management
- ____ For-profit
- ____ Non-profit

2) Type of Tenant Firms
- ____ Start-ups
- ____ Existing businesses
- ____ Mix (percentage)

3) Type of Tenant Firms
- ____ Service
- ____ Light manufacturing
- ____ Research and development
- ____ Advanced technology
- ____ Retail
- ____ Involvement with import/export
- ____ Mix (percentage)
- ____ Other _____

4) Type of Tenant Firms
- ____ Local entrepreneurs
- ____ Minorities
- ____ Women
- ____ Students
- ____ Spinoffs from local corp.
- ____ Other _____

5) Type of Facility
- ____ Former manufacturing plant
- ____ Abandoned school
- ____ Warehouse
- ____ Strip shopping center
- ____ Other _____

6) Location of Facility
- ____ Deteriorated neighborhood
- ____ Rural setting
- ____ Central business district
- ____ Science park near university
- ____ Urban industrial area
- ____ Historic district

7) Incubator Goals

____ Job creation and retention
____ Stimulation of real estate development
____ Creation of outlets for community products
____ Tax base expansion
____ Enhancement of community image
____ Filling economic/industrial gaps
____ Creation of local investment
____ Rehabilitation of vacated property
____ Development of a new business sector
____ Development of suppliers for local companies

8) Board Members

_____ _____
_____ _____
_____ _____
_____ _____
_____ _____

9) Shared Services of Incubator

_____
_____
_____
_____
_____

10) Tenant Policies

- Marketing
- Screening
- Rental/Lease
- Graduation

11) Management Services — Provider

_____ _____
_____ _____
_____ _____
_____ _____
_____ _____

12) Financial Assistance to Firms — Provider

_____ _____
_____ _____
_____ _____
_____ _____
_____ _____

SECTION II. C.

FACILITY SITE SELECTION EVALUATION

Identify and describe the proposed sites and buildings, whether they are publicly owned or commercial facilities, and critique the adequacy, advantages, and disadvantages of the facilities. With details of this nature, the local sponsor can help determine the most suitable site and justify why it has been selected.

SITE _____

BASIC REQUIREMENTS	ADEQUACY (Advantages/Disadvantages)
Amount of Space	
Location	
Price	
Cost of Renovation	
Suitability	
Availability	

SITE _____

BASIC REQUIREMENTS	ADEQUACY (Advantages/Disadvantages)

SITE _____

BASIC REQUIREMENTS	ADEQUACY (Advantages/Disadvantages)

SITE _____

BASIC REQUIREMENTS	ADEQUACY (Advantages/Disadvantages)

SECTION II. D.

FINANCIAL PLAN-INCUBATOR COST DETAIL

Given the proposed incubator and building and site, provide estimates of the cost of establishment, such as any necessary lease, purchase and renovation costs, and equipment and fixture cost associated with the site and building.

AMOUNT REQUIRED	SOURCE OF FUNDS
Acquisition:	
Land/Site Costs	
Building Acquisition	
Renovation:	
Plumbing	
Heating/Cooling	
Plastering/Painting	
Electrical	
Water/Septic	
Fire Protection	
Insulation	
Other Acq/Ren Costs	
Arch./Engineering	
Legal/Appraisal	
Construction Interest	
Contingencies	
Facility Services	
Equipment	
Furnishings	
Operational Costs	
Acct/Legal/Adv.	
Utilities	
Telephone	
Repair/Maintenance	
Taxes	
Insurance	
Equipment Rental	
Interest	
Incubator Management	
Salaries	
Fringes	
Payroll Taxes	
Supplies	
Travel	
Business/Prof. Assist.	
Counseling	
Contractual	
Total Costs	

SECTION II. D.

FINANCIAL PLAN-INCUBATOR PROFITS AND LOSS

Estimate the cost of operation including such items as: salaries and expenses for manager and staff, maintenance, utilities, and related incubator operational costs. Project cash flow out to three years to determine if the incubator is self sufficient.

	YEAR ENDING	YEAR ENDING	YEAR ENDING
Income			
Rental Income			
Other Income			
Grants (List)			
Total Income			
Expenses			
Acct/Legal/Adv.			
Utilities			
Telephone			
Repair/Maintenance			
Taxes			
Insurance			
Equipment Rental			
Salaries			
Fringes			
Payroll Taxes			
Office Supplies			
Travel			
Other (Specify)			
Total Expenses			
Net Profit			

GUIDELINES FOR DETERMINING THE FEASIBILITY OF A SMALL BUSINESS INCUBATOR

Published by the

Illinois Department of Commerce and Community Affairs
620 East Adams Street
Springfield, Illinois 62701
217/782-7500

James R. Thompson, Governor

Jay R. Hedges, Director
Department of Commerce and Community Affairs

Stephen F. Selcke, Assistant Director

George Dinges, Deputy Director
Bureau of Program Administration

EDITOR: ERIC L. RINEHART